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SCOTTSDALE INSURANCE COMPANY

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA – SOUTHERN DIVISION

SCOTTSDALE INSURANCE
COMPANY, an Ohio corporation,

Plaintiff,

v.

BEACHCOMBER MANAGEMENT
CRYSTAL COVE, LLC, a California
limited liability company,

and

BEACHCOMBER AT CRYSTAL
COVE, LLC, a California limited
liability company,

and

SHAKE SHACK CRYSTAL COVE,
LLC, a California limited liability
company,

and

DOUGLAS CAVANAUGH, a
California citizen,

and

RALPH KOSMIDES, a California
citizen,

Defendants.

Case No.:

**COMPLAINT FOR
DECLARATORY JUDGMENT**

1 For its Complaint against Defendants Beachcomber Management Crystal Cove,
2 LLC (“BMCC”), Beachcomber at Crystal Cove, LLC (“BCC”), Shake Shack Crystal
3 Cove, LLC (“SSCC”), Douglas Cavanaugh (“Cavanaugh”), and Ralph Kosmides
4 (“Kosmides”), Plaintiff Scottsdale Insurance Company (“Scottsdale”) states the
5 following.

6 1. This is an insurance coverage action seeking declaratory relief pursuant
7 to 28 U.S.C. §§ 2201, 2202, and 1332.

8 **PARTIES**

9 2. Scottsdale is an insurance company duly organized and existing under the
10 laws of the State of Ohio with its principal office located in Scottsdale, Arizona.

11 3. BMCC is a California limited liability company whose members are
12 citizens of the State of California.

13 4. BCC is a California limited liability company whose members are
14 citizens of the State of California.

15 5. SSCC is a California limited liability company whose members are
16 citizens of the State of California.

17 6. Cavanaugh is a citizen of the State of California and, upon information
18 and belief, is the founder and Chief Executive Officer of BMCC.

19 7. Kosmides is a citizen of the State of California and, upon information and
20 belief, is a former managing member of BMCC.

21 **JURISDICTION AND VENUE**

22 8. The Court has jurisdiction over this action pursuant to 28 U.S.C. §
23 1332(a)(1). There is complete diversity of citizenship between Scottsdale and
24 Defendants, and the amount in controversy exceeds \$75,000, exclusive of interest and
25 costs.

26 9. Venue is proper in this District and Division pursuant to 28 U.S.C. §
27 1391(b)(1) because Defendants are in this District and Division.

FACTUAL ALLEGATIONS

The Prior Policy

10. Underwriters at Lloyd’s, London (“Underwriters”) issued Directors and Officers Liability Insurance Policy No. AUGBC 00186J to BMCC and Ruby’s Diner, Inc. (“RDI”) effective for the period from September 1, 2019 to September 1, 2020 (the “Prior Policy”). A copy of the Prior Policy is attached hereto as “Exhibit 1.”

The Underlying Draft Complaint

11. On or about October 28, 2019, Underwriters received notice of a draft complaint to be filed by the Official Committee of Unsecured Creditors of RDI (the “Committee”) against Cavanaugh and Kosmides in the United States Bankruptcy Court for the Central District of California (the “Underlying Draft Complaint”). A copy of the Underlying Draft Complaint is attached hereto as “Exhibit 2.”

12. In the Underlying Draft Complaint, the Committee alleged that Cavanaugh and/or Kosmides caused RDI to enter into business arrangements with various entities in which Cavanaugh and Kosmides had a financial interest, including but not limited to BMCC, BCC, and SSCC, that were not in the best interest of RDI. (Ex. 2 ¶¶ 14-16.)

13. The Committee alleged in the Underlying Draft Complaint that Cavanaugh and Kosmides breached their fiduciary duties to RDI to ensure that RDI’s business arrangements were made and performed at arm’s length and were financially beneficial to RDI. (Ex. 2 ¶¶ 14-16.)

14. In the Underlying Draft Complaint, the Committee alleged causes of action for: (1) breach of fiduciary duty; (2) recovery of illegal dividends under Cal. Corp. Code §§ 500, 501 and 506; (3) disallowance of proofs of claim pursuant to 11 U.S.C. § 502(d); (4) equitable subordination of claims pursuant to 11 U.S.C. § 510(c); (5) permanent injunction pursuant to Cal. Civ. Code § 3439.07(a)(3)(A); and (6) permanent injunction pursuant to Cal. Civ. Code § 3439.07(a)(3)(C). (Ex. 2.)

The Scottsdale Application

15. On or about August 23, 2020, BMCC completed an Application for Business and Management (BAM) Indemnity Coverage (the “Scottsdale Application”) and submitted it to Scottsdale.

16. In the Scottsdale Application, BMCC was asked about prior claims.

17. BMCC did not disclose the Underlying Draft Complaint in response to Scottsdale’s questions.

The Scottsdale Policy

18. In reliance upon the information contained in the Application, Scottsdale issued claims-made-and-reported Business and Management Indemnity Policy number EKS3353648 to BMCC (the “Scottsdale Policy”) effective for the policy period from November 1, 2020 to November 1, 2021 (the “Scottsdale Policy Period”). A copy of the Scottsdale Policy is attached hereto as “Exhibit 3.”

19. Subject to the Scottsdale Policy’s terms, conditions, limitations, exclusions, and endorsements, the Scottsdale Policy provides coverage under a Directors and Officers and Company Coverage Section (the “D&O Coverage Section”) and an Employment Practices Coverage Section.

20. Insuring Agreement A(1) of the D&O Coverage Section states that Scottsdale shall pay the “Loss” of the “Directors and Officers” for which the “Directors and Officers” are not indemnified by the “Company” and which the “Directors and Officers” have become legally obligated to pay by reason of a “Claim” first made against the “Directors and Officers” during the Scottsdale Policy Period or, if elected, the “Extended Period,” and reported to Scottsdale pursuant to Section E.1. herein, for any “Wrongful Act” taking place prior to the end of the Scottsdale Policy Period. (Ex. 3 at D&O Coverage Section § A(1).)

21. Insuring Agreement A(2) of the D&O Coverage Section states that Scottsdale shall pay the “Loss” of the “Company” for which the “Company” has indemnified the “Directors and Officers” and which the “Directors and Officers” have

1 become legally obligated to pay by reason of a “Claim” first made against the
2 “Directors and Officers” during the Scottsdale Policy Period or, if elected, the
3 “Extended Period,” and reported to Scottsdale pursuant to Section E.1. herein, for any
4 “Wrongful Act” taking place prior to the end of the Scottsdale Policy Period. (Ex. 3 at
5 D&O Coverage Section § A(2).)

6 22. Insuring Agreement A(3) of the D&O Coverage Section states that
7 Scottsdale shall pay the “Loss” of the “Company” which the “Company” becomes
8 legally obligated to pay by reason of a “Claim” first made against the “Company”
9 during the Scottsdale Policy Period or, if applicable, the “Extended Period,” and
10 reported to Scottsdale pursuant to Section E.1. herein, for any “Wrongful Act” taking
11 place prior to the end of the Scottsdale Policy Period. (Ex. 3 at D&O Coverage
12 Section § A(3).)

13 23. The Scottsdale Policy defines “Claim” to include, among other things:

- 14
- 15 a. a written demand against any Insured for monetary damages or
- 16 non-monetary or injunctive relief;
- 17
- 18 b. a written demand by one or more of the securities holders of the
- 19 Company upon the board of directors or the management board of
- 20 the Company to bring a civil proceeding against any of the
- 21 Directors and Officers on behalf of the Company;
- 22
- 23 c. a civil proceeding against any Insured seeking monetary damages
- 24 or non-monetary or injunctive relief, commenced by the service of
- 25 a complaint or similar pleading;

26 . . .

27 (Ex. 3 at D&O Coverage Section § B(1)(c), as amended by Endorsements No. 27, 33,
28 and 41.)

1 24. Section E(1) of the D&O Coverage Section, as amended by Endorsement
2 No. 13 provides: “A Claim shall be deemed to have been first made against the
3 Insureds on the date an Insured who is an executive officer, director or general
4 counsel becomes aware of such Claim.” (Ex. 3 at D&O Coverage Section § E(1), as
5 amended by Endorsement No. 13.)

6 25. Section D(3) of the D&O Coverage Section states, in relevant part:

7
8 All Claims arising out of the same Wrongful Act and all Interrelated
9 Wrongful Acts shall be deemed to be a single Claim, and such Claim
10 shall be deemed to have been made at the earliest of the following times,
11 regardless of whether such date is before or during the Policy Period . . .
12 [t]he time at which the earliest Claim involving the same Wrongful Act
13 or Interrelated Wrongful Acts is first made

14 (the “Single Claim Provision”). (Ex. 3 at D&O Coverage Section § D(3).)

15 26. “Wrongful Act” is defined in the Scottsdale Policy to mean, in pertinent
16 part, any actual or alleged error, omission, misleading statement, misstatement,
17 neglect, breach of duty or act allegedly committed or attempted by any of the
18 “Directors and Officers” while acting in their capacity as such, or any matter claimed
19 against any “Director and Officer” solely by reason of his or her serving in such
20 capacity. (Ex. 3 at D&O Coverage Section § B(9)(a).)

21 27. “Interrelated Wrongful Acts” is defined in the Scottsdale Policy to mean:
22 “all Wrongful Acts that have as a common nexus any fact, circumstance, situation,
23 event, transaction, cause or series of facts, circumstances, situations, events,
24 transactions or causes.” (Ex. 3 at D&O Coverage Section § B(6).)

25 28. “Insured” is defined in the Scottsdale Policy to mean the “Company” and
26 the “Directors and Officers.” (Ex. 3 at D&O Coverage Section § B(5).)

27 29. The Scottsdale Policy defines “Company,” in relevant part, to mean the
28 “Parent Company,” which is defined in the Declarations and Endorsement No. 1 to be

1 BMCC, BCC, Crystal Cove Transportation, Inc., SSCC, and “any Subsidiary.” (Ex. 3
2 at General Terms & Conditions § B(2) and Declarations at Item 1.)

3 30. “Directors and Officers” is defined in the Scottsdale Policy to mean, in
4 pertinent part, any person who was, now is, or shall become, a duly elected or
5 appointed director, officer, or similar executive of the Company, or any member of the
6 management board of the Company. (Ex. 3 at D&O Coverage Section § B(4)(a), as
7 amended by Endorsements No. 5, 23, 30, and 39.)

8 31. The Scottsdale Policy defines “Loss,” in relevant part, to include
9 damages, judgments, settlements, pre-judgment or post-judgment interest awarded by
10 a court, and “Costs, Charges and Expenses” incurred by Directors and Officers under
11 Insuring Clauses 1. or 2., subject to various exceptions. (Ex. 3 at D&O Coverage
12 Section § B(7), as amended by Endorsements No. 7 and 34.)

13 32. “Costs, Charges and Expenses” is defined in the Scottsdale Policy to
14 mean, in pertinent part, reasonable and necessary legal costs, charges, fees and
15 expenses incurred by any of the Insureds in defending Claims and the premium for
16 appeal, attachment or similar bonds arising out of covered judgments, but with no
17 obligation to furnish such bonds and only for the amount of such judgment that is up
18 to the applicable Limit of Liability. (Ex. 3 at D&O Coverage Section § B(3)(a).)

19 33. Section C(1)(b) of the D&O Coverage Section states that Scottsdale shall
20 not be liable for Loss under the D&O Coverage Section on account of any Claim:

21 alleging based upon, arising out of, attributable to, directly or indirectly
22 resulting from, in consequence of, or in any involving:

- 23
- 24 i. any Wrongful Act, fact, circumstance or situation which has been
25 the subject of any written notice given under any other policy of
26 which this Policy is a renewal or replacement or which it succeeds
27 in time; or
28

1 ii. any other Wrongful Act, whenever occurring, which together with
2 a Wrongful Act which has been the subject of such prior notice,
3 would constitute Interrelated Wrongful Acts.

4 (the “Prior Notice Exclusion”). (Ex. 3 at D&O Coverage Section § C(1)(b).)

5 34. The Scottsdale Policy states: “It shall be the duty of [Scottsdale] and not
6 the duty of the Insureds to defend any Claim. Such duty shall exist even if any of the
7 allegations are groundless, false or fraudulent. [Scottsdale]’s duty to defend any Claim
8 shall cease when the Limits of Liability have been exhausted by the payment of Loss
9 including Costs, Charges and Expenses.” (Ex. 3 at D&O Coverage Section § F(1).)

10 35. The Scottsdale Policy further states: “the statements in the Application
11 are [the Insureds]’ representations, that such representations shall be deemed material
12 to the acceptance of the risk or the hazard assumed by [Scottsdale] under this Policy,
13 and . . . this Policy and each Coverage Section are issued in reliance upon the truth of
14 such representations” (Ex. 3 at General Terms & Conditions § D(1).)

15 36. Section D(2) of the General Terms and Conditions of the Scottsdale
16 Policy, as amended by Endorsement No. 22, states, in pertinent part:

17 In the event the Application, including materials submitted or required to
18 be submitted herewith, contains any misrepresentation or omission made
19 with the intent to deceive, or contains any misrepresentation or omission
20 which materially affects either the acceptance of the risk or hazard
21 assumed by [Scottsdale] under this Policy, this Policy, including each
22 and all Coverage Sections, shall not afford coverage to the following
23 Insureds for any Claim alleging, based upon, arising out of, attributable
24 to, directly or indirectly resulting from, in consequence of, or in any way
25 involving, any untruthful or inaccurate statements, representations or
26 information:
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1 a. any Insured who is a natural person and who knew the facts
2 misrepresented or the omissions, whether or not such individual
3 knew of the Application, such materials, or this Policy;

4
5 b. any Company or Sponsor Company to the extent it indemnifies
6 any Insured referred to in subsection a. above; and

7
8 c. any Company, Sponsor Company, Plan, Employee Benefit Plan, or
9 any other entity that is an Insured, if any past or present chief
10 executive officer, chief financial officers, general counsel, risk
11 manager or human resources director (or equivalent positions) of
12 the Parent Company knew the facts misrepresented or the
13 omissions, whether or not such individual know of the
14 Application, such materials, or this Policy.

15 . . .

16 (the “Warranty Exclusion”). (Ex. 3 at General Terms & Conditions § D(2), as
17 amended by Endorsement No. 22.)

18 **The Underlying Action**

19 37. On or about March 11, 2021, Richard A. Marshack, Chapter 7 Trustee
20 (the “Trustee”) of the jointly-administered estates of RDI, Ruby’s SoCal Diners, LLC,
21 Ruby Quality Diners, LLC, Ruby’s Huntington Beach, Ltd., Ruby’s Laguna Hills,
22 Ltd., Ruby’s Oceanside Ltd., and Ruby’s Palm Springs, Ltd. filed a lawsuit against
23 Cavanaugh, Kosmides, BMCC, BCC, SSCC, and others, Case No. 8:18-bk-13311-SC,
24 in the United States Bankruptcy Court for the Central District of California (the
25 “Underlying Action”).

26 38. In the complaint filed in the Underlying Action (the “Underlying
27 Complaint”), the Trustee alleges that Cavanaugh and Kosmides, RDI’s founders,
28 diverted corporate opportunities from RDI to other entities controlled by Cavanaugh

1 and Kosmides and transferred RDI assets to those other entities owned and/or
2 controlled by Cavanaugh and Kosmides without adequate consideration. A copy of the
3 Underlying Complaint is attached hereto as “Exhibit 4.”

4 39. In the Underlying Action, the Trustee asserts the following causes of
5 action: (1) breach of fiduciary duty (against Cavanaugh and Kosmides); (2) aiding and
6 abetting breach of fiduciary duties (against BMCC, BCC, SSCC, and others); (3)
7 avoidance of actually fraudulent transfers pursuant to 11 U.S.C. § 548(a)(1)(A)
8 (against Cavanaugh and Kosmides); (4) avoidance of constructively fraudulent
9 transfers pursuant to 11 U.S.C. § 548(a)(1)(B) (against Cavanaugh and Kosmides); (5)
10 recovery of fraudulent transfers pursuant to 11 U.S.C. §§ 550 and 551; (6) avoidance
11 and recovery of actually fraudulent transfers pursuant to 11 U.S.C. § 544 and Cal. Civ.
12 Code § 3439.04; (7) avoidance and recovery of constructively fraudulent transfers
13 pursuant to 11 U.S.C. § 544 and Cal. Civ. Code § 3439.05; (8) recovery of illegal
14 dividends under Cal. Corp. Code §§ 500, 501 and 506 (against Cavanaugh and
15 Kosmides); (9) equitable subordination of claims pursuant to 11 U.S.C. § 510(c); (10)
16 permanent injunction pursuant to Cal. Civ. Code § 3439.07(a)(3)(A); (11) permanent
17 injunction pursuant to Cal. Civ. Code § 3439.07(a)(3)(C); (12) breach of contract
18 (against Cavanaugh and Kosmides); (13) money lent (against Cavanaugh and
19 Kosmides); (14) open book account (against Cavanaugh and Kosmides); (15)
20 violation of Cal. Penal Code § 496(c); (16) accounting; (17) constructive trust; and
21 (18) misappropriation of trade secrets. (Ex. 4.)

22 40. In the Underlying Action, the Trustee seeks damages in excess of \$35
23 million; interest; punitive damages; transfer of ownership and management of BMCC,
24 SSCC, and others; injunctive relief; treble damages; and attorney’s fees and costs. (Ex.
25 4.)

26 **Scottsdale’s Coverage Position**

27 41. After Scottsdale was provided with notice of the Underlying Action, on
28 or about May 3, 2021, Scottsdale sent a letter and an e-mail to the Insureds indicating

1 that there was no coverage for the Underlying Action under the Scottsdale Policy by
2 virtue of the Prior Notice Exclusion, because the Underlying Action constitutes a
3 Claim that was first made prior to the Scottsdale Policy Period, and by virtue of the
4 Warranty Exclusion due to the Insureds' failure to disclose the Underlying Draft
5 Complaint in response to the Prior and Pending Question and the Prior Claim
6 Question in the Scottsdale Application. In addition, Scottsdale reserved all of its rights
7 under the Scottsdale Policy and at law. Copies of Scottsdale's May 3, 2021 letter and
8 e-mail to the Insureds are attached hereto as "Exhibit 5."

9 **COUNT I – DECLARATORY JUDGMENT AS TO PRIOR NOTICE**

10 **EXCLUSION**

11 42. Scottsdale hereby adopts by reference the allegations contained in
12 paragraphs 1 through 41 of this Complaint as if fully set forth herein.

13 43. An actual, present, and justiciable controversy exists concerning whether
14 the Prior Notice Exclusion bars coverage for the Underlying Action under the
15 Scottsdale Policy.

16 44. Scottsdale requests that the Court declare that the Prior Notice Exclusion
17 bars coverage for the Underlying Action under the Scottsdale Policy and, as a result,
18 Scottsdale has no duty to defend and/or indemnify the Insureds under the Scottsdale
19 Policy in connection with the Underlying Action.

20 **COUNT II – DECLARATORY JUDGMENT AS TO SINGLE CLAIM FIRST**

21 **MADE PRIOR TO SCOTTSDALE POLCY PERIOD**

22 45. Scottsdale hereby adopts by reference the allegations contained in
23 paragraphs 1 through 44 of this Complaint as if fully set forth herein.

24 46. An actual, present, and justiciable controversy exists concerning whether
25 the Underlying Action constitutes a Claim that was first made prior to the Scottsdale
26 Policy Period.

27 47. Scottsdale requests that the Court declare that the Underlying Action does
28 not constitute a Claim that was first made during the Scottsdale Policy Period and, as a

1 result, the Underlying Action does not fall within the scope of coverage of the
2 Scottsdale Policy and, therefore, Scottsdale has no duty to defend and/or indemnify
3 the Insureds under the Scottsdale Policy in connection with the Underlying Action.

4 **COUNT III – DECLARATORY JUDGMENT AS TO WARRANTY**

5 **EXCLUSION**

6 48. Scottsdale hereby adopts by reference the allegations contained in
7 paragraphs 1 through 47 of this Complaint as if fully set forth herein.

8 49. An actual, present, and justiciable controversy exists concerning whether
9 the Warranty Exclusion bars coverage for the Underlying Action under the Scottsdale
10 Policy.

11 50. Scottsdale requests that the Court declare that the Warranty Exclusion
12 bars coverage for the Underlying Action under the Scottsdale Policy and, as a result,
13 Scottsdale has no duty to defend and/or indemnify the Insureds under the Scottsdale
14 Policy in connection with the Underlying Action.

15 **PRAYER FOR RELIEF**

16 **WHEREFORE**, Scottsdale prays that this Court enter an Order:

17 1. declaring that the Prior Notice Exclusion bars coverage for the
18 Underlying Action under the Scottsdale Policy and, as a result, Scottsdale has no duty
19 to defend and/or indemnify the Insureds under the Scottsdale Policy in connection
20 with the Underlying Action;

21 2. declaring that the Underlying Action does not constitute a Claim that was
22 first made during the Scottsdale Policy Period and, as a result, the Underlying Action
23 does not fall within the scope of coverage of the Scottsdale Policy and, therefore,
24 Scottsdale has no duty to defend and/or indemnify the Insureds under the Scottsdale
25 Policy in connection with the Underlying Action;

26 3. declaring that the Warranty Exclusion bars coverage for the Underlying
27 Action under the Scottsdale Policy and, as a result, Scottsdale has no duty to defend
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1 and/or indemnify the Insureds under the Scottsdale Policy in connection with the
2 Underlying Action.

3 4. awarding Scottsdale its costs and expenses together with pre- and post-
4 judgment interest to the greatest extent allowed by law; and

5 5. awarding Scottsdale all other relief that the Court deems just and
6 equitable.

7 DATED: July 12, 2022

COZEN O'CONNOR

8
9 By: /s/Valerie D. Rojas

10 Valerie D. Rojas

11 Attorneys for Plaintiff

12 SCOTTSDALE INSURANCE COMPANY
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